



8011-01

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79274; File No. SR-Phlx-2016-79)

November 9, 2016

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing of Partial Amendment No. 2 and Order Granting Approval of a Proposed Rule Change, as Modified by Partial Amendment No. 2, to Amend PHLX Rule 1017, Openings in Options

I. Introduction

On August 4, 2016, NASDAQ PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its rules governing the opening of trading in options series on the Exchange. The proposed rule change was published for comment in the Federal Register on August 22, 2016.³ The Commission received no comment letters regarding the proposed rule change. On October 3, 2016, pursuant to Section 19(b)(2) of the Act,⁴ the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁵ On November 7, 2016, the Exchange filed Partial Amendment No. 1 to the proposed rule change

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 78588 (August 16, 2016), 81 FR 56733 (“Notice”).

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 79024, 81 FR 69892 (October 7, 2016). The Commission designated a longer period within which to take action on the proposed rule change and designated November 20, 2016, as the date by which it should approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change.

(“Partial Amendment No. 1”).⁶ On November 8, 2016, the Exchange filed Partial Amendment No. 2 to the proposed rule change, which superseded Partial Amendment No. 1 (“Partial Amendment No. 2”).⁷ The Commission is publishing this order to approve the proposed rule change, as modified by Partial Amendment No. 2.

II. Description

The Exchange has proposed to reorganize and amend current Rule 1017, which describes the opening of trading in option series on the Exchange.⁸

A. Definitions

The Exchange proposes to revise the introductory language to Rule 1017(a) to state that it would conduct an electronic opening for all option series traded on Phlx using its trading system (“system”).⁹ In addition, the Exchange proposes to revise Phlx Rule 1017(a) to define several of the terms used in proposed Phlx Rule 1017. The Exchange proposes to define “Opening

⁶ Partial Amendment No. 1 is available at: <https://www.sec.gov/comments/sr-phlx-2016-79/phlx201679-1.pdf>.

⁷ In Partial Amendment No. 2, Phlx amends its proposed rule change to: (1) specify that references to “quotes” refer to two-sided quotes; (2) provide additional rationale for the OQR and for boundaries that protect the Opening Price from trading through the limit price(s) of interest within OQR, which is unable to fully execute at the Opening Price; (3) state that in the event the Exchange routes to away markets and uses the away market price as the Opening Price, the Exchange will enter on its order book any unfilled interest at a price equal to or inferior than the Opening Price and the Exchange would route orders that would execute through the Opening Price; (4) explain that each Imbalance Message would be set for the same length of time; (5) include additional rationale for proposed changes to routing during the Opening Process; (6) provide examples for how certain parts of the Opening Process operate; and (7) revise the filing and the Exhibit 5 to state that the Exchange may open with the PBBO only if there are no routable orders locking the ABBO. Partial Amendment No. 2 is available at: <https://www.sec.gov/comments/sr-phlx-2016-79/phlx201679-2.pdf>.

⁸ For a complete description on the proposal, please refer to the Notice, supra note 3 and Partial Amendment No. 2, supra note 7.

⁹ See Phlx Rule 1017(a).

Process” by cross-referencing Rule 1017(d),¹⁰ “Opening Price” by cross-referencing Rule 1017(i) and (k),¹¹ and “Potential Opening Price” by cross-referencing Rule 1017(h).¹² The Exchange also proposes to define the following terms:

- “ABBO” as the Away Best Bid or Offer;¹³
- “Phlx Electronic Market Maker” as a Specialist,¹⁴ Streaming Quote Trader,¹⁵ or Remote Streaming Quote Trader¹⁶ who is required to submit continuous two-sided electronics quotations pursuant to Rule 1014(b)(ii)(D);¹⁷
- “Pre-Market BBO” as the highest bid and lowest offer among Valid Width Quotes;¹⁸
- “Quality Opening Market” as the bid/ask differential applicable to the best bid and offer from all Valid Width Quotes defined in a table to be determined by the Exchange and published on the Exchange’s website;¹⁹
- “Valid Width Quote” as the two-sided electronic quotation submitted by a Phlx Electronic Market Maker that consists of a bid/ask differential that is compliant with Rule 1014(c)(i)(A)(1)(a);²⁰ and
- “Zero Bid Market” as where the best bid for an options series is zero.²¹

¹⁰ See Phlx Rule 1017(a)(i).

¹¹ See Phlx Rule 1017(a)(ii).

¹² See Phlx Rule 1017(a)(iii).

¹³ See Phlx Rule 1017(a)(iv).

¹⁴ A Specialist is an Exchange member who is registered as an options specialist pursuant to Phlx Rule 1020(a). An options Specialist includes a Remote Specialist which is defined as an options Specialist in one or more classes that does not have a physical presence on an Exchange floor and that is approved by the Exchange pursuant to Phlx Rule 501.

¹⁵ See Phlx Rule 1014(b)(ii)(A).

¹⁶ See Phlx Rule 1014(b)(ii)(B).

¹⁷ See Phlx Rule 1017(a)(vi).

¹⁸ See Phlx Rule 1017(a)(vii).

¹⁹ See Phlx Rule 1017(a)(viii).

²⁰ See Phlx Rule 1017(a)(ix).

²¹ See Phlx Rule 1017(a)(x).

In addition, the Exchange proposes to define the “market for the underlying security” as either the primary listing market or the primary volume market (defined as the market with the most liquidity in that underlying security for the previous two calendar months), as determined by the Exchange by underlying and announced to the Exchange’s membership on the Exchange’s website.²² This would revise the current definition of the “market for the underlying security,” which is defined in current Rule 1017(j), and includes the first market to open.²³

B. Interest Included in the Opening Process

Under the proposal, eligible interest during the Opening Process would include Valid Width Quotes, Opening Sweeps,²⁴ and orders.²⁵ Phlx proposes to permit Phlx Electronic Market Makers to submit quotes,²⁶ Opening Sweeps, and orders. Phlx proposes that two-sided quotes other than Valid Width Quotes would not be included in the Opening Process. Under the proposal, Non-SQT Registered Options Traders may submit orders. Phlx also proposes that all-or-none interest that can be satisfied would be considered in determining the Opening Price.²⁷

The proposed rule provides that a Phlx Electronic Market Maker assigned in a particular option may only submit an Opening Sweep if, at the time of entry of the Opening Sweep, that Phlx Electronic Market Maker has already submitted and maintained a Valid Width Quote. All Opening Sweeps in the affected series entered by a Phlx Electronic Market Maker would be

²² See Phlx Rule 1017(a)(v).

²³ See Notice, 81 FR at 56734.

²⁴ Phlx Rule 1017(b)(i) defines an Opening Sweep as a one-sided electronic quotation submitted for execution against eligible interest in the system during the Opening Process.

²⁵ See Phlx Rule 1017(b).

²⁶ The term “quotes” refers to two-sided quotes. See Partial Amendment No. 2, supra note 7.

²⁷ Id.

cancelled immediately if that Phlx Electronic Market Maker fails to maintain a continuous quote with a Valid Width Quote in the affected series.²⁸ The Exchange is also proposing that Opening Sweeps may be entered at any price with a minimum price variation applicable to the affected series, on either side of the market, at single or multiple price level(s), and may be cancelled and re-entered. A single Phlx Electronic Market Maker may enter multiple Opening Sweeps, with each Opening Sweep at a different price level. If a Phlx Electronic Market Maker submits multiple Opening Sweeps, the system would consider only the most recent Opening Sweep at each price level submitted by that Phlx Electronic Market Maker in determining the Opening Price. Unexecuted Opening Sweeps would be cancelled once the affected series is open.²⁹

Currently, the Phlx rules provide that the system will use only Opening Sweeps submitted by Phlx Electronic Market Makers to determine the pro-rata allocation.³⁰ Phlx proposes to change its rules so that the system would aggregate the size of all eligible interest for a particular participant category (e.g., all Phlx Electronic Market Maker (a participant category) quotes, Opening Sweeps, and orders are aggregated in determining the pro-rata allocation) at a particular price level for trade allocation purposes.³¹ Additionally, the Exchange is proposing that orders represented by Floor Brokers must be entered electronically to be considered in the Opening Process.³² Under proposed Rule 1017(d), Phlx Electronic Market Maker Valid Width Quotes and Opening Sweeps received starting at 9:25 a.m. and orders entered at any time before a series opens would be included in the Opening Process.

²⁸ See Phlx Rule 1017(b)(i)(A).

²⁹ See Phlx Rule 1017(b)(i)(B).

³⁰ See Notice, supra note 3, at 56735.

³¹ See Phlx Rule 1017(b)(ii).

³² See Phlx Rule 1017(c).

C. Opening Processes

Under proposed Rule 1017(d), the Opening Process for an option series would be conducted pursuant to Rule 1017(f) – (k) on or after 9:30 a.m. if: (1) the ABBO, if any, is not crossed; and (2) the system has received, within two minutes of the opening trade or quote on the market for the underlying security in the case of equity options or, in the case of index options, within two minutes of the receipt of the Opening Price in the underlying index, or within two minutes of market opening in the case of U.S. dollar-settled foreign currency options, either:

- (a) the Specialist's Valid Width Quote;
- (b) the Valid Width Quotes of at least two Phlx Electronic Market Makers other than the Specialist; or
- (c) if neither the Specialist's Valid Width Quote nor the Valid Width Quotes of two Phlx Electronic Market Makers have been submitted within such timeframe, one Phlx Electronic Market Maker has submitted a Valid Width Quote.³³

The Exchange proposes that for all options, the underlying security, including indexes, must be open on the primary market for a certain period of time as determined by the Exchange, which shall be no less than 100 milliseconds and no more than 5 seconds.³⁴ According to the Exchange, this range is designed to allow it to respond to volatility by requiring the underlying to be open for a longer or shorter period of time prior to opening to ensure more stability in the marketplace before initiating the Opening Process.³⁵

³³ See Phlx Rule 1017(d)(i). The Exchange represents that these conditions are the same as those in current Rule 1017(k). See Notice, supra note 3, at 56736.

³⁴ Phlx Rule 1017(d)(ii). The Exchange represents that it currently applies a minimal delay of 500 milliseconds. See Notice, supra note 3, at 56736.

³⁵ See Notice, supra note 3, at 56736.

Under proposed Rule 1017(d)(iii), the Specialist assigned in a particular equity option must enter a Valid Width Quote no later than one minute following the dissemination of a quote or trade by the market for the underlying security or, in the case of index options, following the receipt of the Opening Price in the underlying index. The Specialist assigned in a particular U.S. dollar-settled foreign currency option must enter a Valid Width Quote not later than 30 seconds after the announced market opening.³⁶ Under proposed Rule 1017(d)(iv), a Phlx Electronic Market Maker (other than a Specialist) that submits a quote pursuant to Rule 1017 in any option series when the Specialist's quote has not been submitted would be required to submit continuous, two-sided quotes in that option series until the time that the Specialist submits his or her quote, after which the Phlx Electronic Market Maker that submitted such quote would be obligated to submit quotations pursuant to Rule 1014(b)(ii)(D).³⁷

As proposed, the Opening Process would stop and an option series would not open if the away best bid or offer ("ABBO") becomes crossed or when the requisite number of Valid Width Quotes pursuant to Rule 1017(d)(i) is no longer present. The Exchange states that it would wait for the ABBO to become uncrossed before initiating the Opening Process to ensure that there is stability in the marketplace as the Exchange determines the Opening Price.³⁸ Once each of these conditions no longer exist, the Opening Process in the affected option series would start again pursuant to the Opening Process described in Rule 1017(f)-(k). The Exchange is proposing to

³⁶ Id. The Exchange represents that these obligations are unchanged from those in the current rule text.

³⁷ Id. The Exchange represents that this process is substantially unchanged from the current rule text.

³⁸ Id.

use the process described in Rule 1017 to reopen an option series after a trading halt, irrespective of the specific times described in proposed Rule 1017(d).³⁹

D. Opening with a PBBO

Under proposed Rule 1017(f), if there are no opening quotes or orders that lock or cross each other and no routable orders locking or crossing the ABBO, Phlx would open with an opening quote by disseminating the Exchange's best bid and offer among quotes and orders ("PBBO") that exist in the system at that time, unless the following three conditions exist: (i) a Zero Bid Market; (ii) no ABBO; and (iii) no Quality Opening Market. If all of these conditions exist, the Exchange would calculate an Opening Quote Range ("OQR") and conduct the price discovery mechanism ("PDM").⁴⁰ The Exchange believes that when these conditions exist, it would be difficult to arrive at a reasonable price, and therefore, further price discovery is warranted.⁴¹

E. Pre-Market BBO Calculation

Pursuant to proposed Rule 1017(g), the system would calculate a Pre-Market BBO if there are opening Valid Width Quotes or orders that lock or cross each other. The Exchange represents that this is provided for in the current rule text.⁴²

³⁹ Phlx Rule 1017(e). The Exchange represents that other than the reference to the specific times, the reopening process is currently described in Rule 1017(h). See Notice, supra note 3, at 56736.

⁴⁰ See infra Section II.I.

⁴¹ Id. The proposed rule differs from current Rule 1017(l)(i), which provides that if there are no opening quotes or orders that lock or cross each other, the system will open.

⁴² See Notice, supra note 3, at 56736.

F. Potential Opening Price

Proposed Rule 1017(h) describes how the system calculates the Potential Opening Price once the Opening Process begins.⁴³ To calculate the Potential Opening Price, Phlx considers all Valid Width Quotes, Opening Sweeps, and orders, except all-or-none interest that cannot be satisfied, to identify the price at which the maximum number of contracts can trade (“maximum quantity criterion”).⁴⁴ The Exchange states that the proposed rule, like the current rule, aims to maximize the number of contracts that can trade to find the most reasonable and suitable price.⁴⁵

Under proposed Rule 1017(h)(A), when two or more Potential Opening Prices would satisfy the maximum quantity criterion and leave no contracts unexecuted, the system would use the highest and lowest of those prices to calculate the mid-point. If the mid-point is not expressed as a permitted minimum price variation, it would be rounded to the minimum price variation that is nearest to the closing price for the affected series from the immediate prior trading session. If there is no closing price from the immediate prior trading session, the system would round the mid-point price up to the minimum price variation to determine the Opening Price. The Exchange states that this is similar to current Rule 1017(l)(ii)(B), but the Exchange has added that this method of calculating the Opening Price would occur where two or more Potential Opening Prices would leave no contracts unexecuted.⁴⁶

Under proposed Rule 1017(h)(B), the Exchange would add that if two or more Potential Opening Prices for the affected series would satisfy the maximum quantity criterion and leave contracts unexecuted, the Opening Price would be either the lowest executable bid or highest

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Id.

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See Phlx Rule 1017(h).

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See Notice, supra note 3, at 56737.

⁴⁶

Id.

executable offer of the largest sized side. This is designed to base the Potential Opening Price on the maximum quantity of contracts that are executable.⁴⁷ As described in new Rule 1017(h)(C), the Potential Opening Price would be bounded by the away market price that may not be satisfied with the Exchange routable interest.⁴⁸ According to the Exchange, proposed Rule 1017(h)(c) would ensure that the Exchange would not open with a trade that would trade through another market.

G. Opening With Trade

Under proposed Rule 1017(i), the Exchange would open the option series for trading at the following Opening Price if: (1) the Potential Opening Price is at or within the best of the Pre-Market BBO and the ABBO; (2) the Potential Opening Price is at or within the non-zero bid ABBO if the Pre-Market BBO is crossed; or (3) where there is no ABBO, the Potential Opening Price is at or within the Pre-Market BBO that is also a Quality Opening Market. If there is more than one Potential Opening Price that would meet these conditions where no contracts would be left unexecuted and any value used for the mid-point calculation crosses either the Pre-Market BBO or the ABBO, then the Exchange would open the option series for trading and use the best price that the Potential Opening Price crosses outside as a boundary price for the purposes of the mid-point calculation. The Exchange states that the purpose of these boundaries is to help ensure that the Potential Opening Price is reasonable and does not trade through other markets.⁴⁹

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Id.

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Phlx Rule 1017(h)(C).

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See Notice, supra note 3, at 56737.

H. Calculation of the Opening Quote Range

The Exchange proposes that the system would calculate an OQR for an option series that would be used in the PDM.⁵⁰ The Exchange states that the OQR is an additional boundary designed to limit the Opening Price to a reasonable price and reduce the potential for erroneous trades during the Opening Process.⁵¹ Except as provided in proposed Rule 1017(j)(3) and (4), to determine the minimum value for the OQR, an amount, as defined in a table to be determined by the Exchange, would be subtracted from the highest quote bid among Valid Width Quotes on the Exchange and on the away market(s), if any. Under proposed Rule 1017(j)(3), if one or more away markets have disseminated opening quotes that are not crossed, and there are Valid Width Quotes on the Exchange that cross each other or that cross away market quotes, the minimum value for the OQR would be the highest quote bid among quotes on away market(s), and the maximum value for the OQR would be the lowest quote offer among quotes on away market(s). Under proposed Rule 1017(j)(4), if there are opening quotes on the Exchange that cross each other, and there is no away market in the affected option series, the minimum value for the OQR would be the lowest quote bid among Valid Width Quotes on the Exchange, and the maximum value for the OQR would be the highest quote offer among Valid Width Quotes on the Exchange.⁵²

Under proposed Rule 1017(j)(5), if there is more than one Potential Opening Price possible where no contracts would be left unexecuted, any Potential Opening Price used for the mid-point calculation (described in Rule 1017(h)) that is outside the OQR would be restricted to

⁵⁰ Phlx Rule 1017(j).

⁵¹ See Notice, supra note 3, at 56741.

⁵² Id. The Exchange represents that the process under Rule 1017(j)(1)-(4) is the same as the process described in current Rule 1017(l)(iii) and (iv), except that the new Rule 1017(j) combines those concepts into a single provision.

the OQR price on that side of the market for the purposes of the mid-point calculation. Proposed Rule 1017(j)(6) would provide that if there is more than one Potential Opening Price possible where no contracts would be left unexecuted and any price used for the mid-point calculation (described in Rule 1017(h)) is an away market price when contracts would be routed, the system would use the away market price as the Potential Opening Price. The Exchange states that it uses the away market price as the Opening Price because the system may need to route to other markets.⁵³ Under proposed Rule 1017(j)(7), if non-routable interest can be maximum executable against Exchange interest after the system determines that routable interest satisfies the away market, then the Potential Opening Price is the price at which the maximum volume, excluding the volume that would be routed to an away market, may be executed on the Exchange as described in proposed Rule 1017(h). The Exchange also proposes that the system would consider routable customer interest in price/time priority to satisfy the away market.

I. Price Discovery Mechanism

Current Rule 1017(l)(vi), which the Exchange proposes to delete, provides that if all opening marketable size cannot be completely executed at or within the OQR without trading through the ABBO, the Exchange would conduct a price discovery process. Under proposed Rule 1017(k), the Exchange would conduct the PDM, after the OQR calculation, if it has not opened pursuant to the processes described in Rule 1017(f) or (i). According to the Exchange, the purpose of the PDM is to satisfy the maximum number of contracts possible by applying wider price boundaries and seeking additional liquidity.⁵⁴

Under the proposal, first, the Exchange would broadcast an imbalance message (including the symbol, side of the imbalance (unmatched contracts), size of matched contracts,

⁵³ Id.

⁵⁴ Id. at 56738.

size of the imbalance, and price of the affected series, which must be within the Pre-Market BBO) to participants (“Imbalance Message”), and begin an “imbalance timer” (“Imbalance Timer”) that would not exceed three seconds and would be for the same number of seconds for all options traded on the Exchange. The Exchange notes that this provision is the same as in the existing rule, except that the Exchange is adding the requirement that the Imbalance Message must be within the Pre-Market BBO to ensure that the price is reasonable.⁵⁵

Under proposed Rule 1017(k)(B), any new interest received by the system would then update the Potential Opening Price. If during or at the end of the Imbalance Timer, the Opening Price is at or within the OQR, the Imbalance Timer would end and the system would execute at the Opening Price. However, this would occur only if the executions consist of Exchange interest only without trading through: (1) the ABBO and (2) the limit price(s) of interest within the OQR that is unable to be fully executed at the Opening Price. Under the proposal, if no new interest comes in during the Imbalance Timer, and the Opening Price is at or within the OQR, the Exchange would open at the end of the Imbalance Timer.

If the option series has not opened pursuant to proposed Rule 1017(k)(B), the system would (1) send a second Imbalance Message with a Potential Opening Price that is bounded by the OQR (without trading through the limit price(s) of interest within the OQR which is unable to be fully executed at the Opening Price) and includes away market volume in the size of the imbalance to participants; and concurrently (2) initiate a route timer, not to exceed one second (“Route Timer”). Current Rule 1017(l)(ii)(C) provides that if the Exchange’s opening price includes away interest, the system would initiate a route timer, and then subsequently route to other markets disseminating prices better than the Exchange’s opening price, execute marketable

⁵⁵ The Exchange represents that the Imbalance Timer will be the same number of seconds for all options traded on the Exchange. See Notice, supra note 3, at 56738.

interest at the Exchange's opening price, and route to other markets disseminating prices equal to the Exchange's opening price if necessary. However, under the proposed rule change, the Route Timer would be initiated during the imbalance process.

The Exchange states that the Route Timer is intended to give participants an opportunity to respond to an Imbalance Message before any opening interest is routed to away markets and thereby, maximize trading on the Exchange.⁵⁶ As proposed, the Route Timer would operate as a pause before an order is routed to an away market. If, during the Route Timer, interest is received by the system that would allow the Opening Price to be within the OQR without trading through other markets and without trading through the limit price(s) of interest within the OQR that is unable to be fully executed at the Opening Price, the system would trade and the Route Timer would end. The system would monitor quotes received during the Route Timer period and make ongoing corresponding changes to the permitted OQR to reflect them. The Exchange notes that this proposed rule change would revise the current rule requirement that there be no imbalance for the Exchange to open and widen the boundary of available Opening Prices, which the Exchange believes would make it more likely that an Opening Price be discovered.⁵⁷

Proposed Rule 1017(k)(C)(3) would provide that when the Route Timer expires, if the Potential Opening Price is within the OQR (without trading through the limit price(s) of interest within the OQR that is unable to be fully executed at the Opening Price), the system would determine if the total number of contracts displayed at better prices than the Exchange's Potential Opening Price on away markets ("better priced away contracts") would satisfy the number of marketable contracts available on the Exchange. Under the proposal, the Exchange would open

⁵⁶ Id. at 56739. The Exchange represents that the system would not route away until the Route Timer ends.

⁵⁷ Id.

the option by routing and/or trading on the Exchange, pursuant to Rule 1017(k)(C)(3)(i)-(iii).

The Exchange represents that under the proposal, as under the current rule, the Exchange would apply the OQR as a boundary before considering away markets.⁵⁸

Pursuant to proposed Rule 1017(k)(C)(3)(i), if the total number of better priced away contracts would satisfy the number of marketable contracts available on the Exchange on either the buy or sell side, the system would route all marketable contracts on the Exchange to the better priced away markets as an intermarket sweep order (“ISO”) designated as an immediate-or-cancel order(s) (“IOC”), and determine an opening PBBO that reflects the interest remaining on the Exchange. In contrast with the current rule, which states that contracts routed away are priced at the better away market price, under the proposed rule, the system would price any contracts routed away to other markets at the Exchange’s Opening Price.

Under proposed Rule 1017(k)(C)(3)(ii), if the total number of better priced away contracts would not satisfy the number of marketable contracts the Exchange has, the system would determine how many contracts it has available at the Opening Price. If the total number of better priced away contracts plus the number of contracts available at the Opening Price would satisfy the number of marketable contracts on the Exchange on either the buy or sell side, the system would contemporaneously route a number of contracts that would satisfy interest at other markets at prices better than the Opening Price and trade available contracts on the Exchange at the Opening Price. The system would price any contracts routed to other markets at the better of the Opening Price or the order’s limit price pursuant to Rule 1017(k)(C)(3)(ii) at the Opening Price. Under the current rules of the Exchange, the Exchange will execute only at the Opening Price, and does not specify that the system would use the better of the Opening Price or

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Id.

the order's limit price to route to away markets. The Exchange states that this proposed Rule 1017(k)(C)(3)(ii) is designed to maximize execution of interest on the Exchange or away markets.⁵⁹

Proposed Rule 1017(k)(C)(3)(iii) provides that if the total number of better priced away contracts plus the number of contracts available at the Opening Price plus the contracts available at other markets at the Opening Price would satisfy the number of marketable contracts the Exchange has on either the buy or sell side, the system would contemporaneously route a number of contracts that would satisfy interest at other markets at prices better than the Opening Price (pricing any contracts routed to other markets at the better of the Opening Price or the order's limit price), trade available contracts on the Exchange at the Opening Price, and route a number of contracts that would satisfy interest at other markets at prices equal to the Opening Price. The Exchange notes that the proposed rule adds a reference to the order's limit price. The Exchange states that routing at the better of the Opening Price or the order's limit price is intended to achieve the best possible price available at the time the order is received by the away market and that routing at the order's limit price ensures that the order's limit price is not violated.⁶⁰

Under proposed Rule 1017(k)(C)(4), after the first and second Imbalance Messages, each of which would be set for the same amount of time and would last for the length of the Imbalance Timer, the system may send up to two additional Imbalance Messages (which may occur while the Route Timer is operating) bounded by the OQR and reflecting away market interest in the volume. After the Route Timer has expired, the processes in Rule 1017(k)(C)(3) would repeat. However, unlike as provided in current Rule 1017(l)(vii)(C)(6), a new Route Timer would not be initiated

⁵⁹ See Notice, supra note 3, at 56739.

⁶⁰ Id.

The Exchange proposes that, pursuant to proposed Rule 1017(k)(C)(5), after all additional Imbalance Messages have occurred pursuant to proposed Rule 1017(k)(C)(4), the system would open as many contracts as possible by routing to other markets at prices better than the Opening Price for their disseminated size, trading available contracts on the Exchange at the Opening Price bounded by the OQR (without trading through the limit price(s) of interest within the OQR which is unable to be fully executed at the Opening Price), and routing contracts to other markets at prices equal to the Opening Price at their disseminated size. In this situation, the system would price any contracts routed to other markets at the better of the Opening Price or the order's limit price. Any unexecuted contracts from the imbalance not traded or routed would be cancelled back to the entering participant if they remain unexecuted and priced through the Opening Price, unless the member that submitted the original order has instructed the Exchange in writing to re-enter the remaining size, in which case the remaining size would be automatically submitted as a new order. The Exchange notes that this is similar to the text of the current rule, but that the Exchange is deleting text that provides that before an order is cancelled back or re-entered, it would be displayed in the Exchange's quote at the Opening Price for the remaining size for a period not to exceed ten seconds.⁶¹ The Exchange represents that this does not occur as the Exchange has set this time period for zero seconds.⁶² Accordingly, the Exchange is also deleting language that provides that during the display time period, the system would disseminate, on the opposite side of the market from remaining contracts: (1) a non-firm bid for the price and size of the next available bid(s) on the Exchange if the imbalance is a sell imbalance, or (2) a non-firm offer for the price and size of the next available offer(s) on the

⁶¹ Id. at 56740.

⁶² Id.

Exchange if the imbalance is a buy imbalance. The Exchange believes that this provision is no longer necessary as there is no display time period under the proposed rule.⁶³

Under proposed Rule 1017(k)(C)(6), the system would execute orders at the Opening Price that have contingencies (such as, without limitation, all-or-none) and non-routable orders, such as a “Do Not Route” or “DNR” Orders, to the extent possible.⁶⁴ The system would only route non-contingency customer orders. The Exchange proposes that under Rule 1017(k)(D), the system would: (1) re-price DNR orders (that would otherwise have to be routed to the exchange(s) disseminating the ABBO for an opening to occur) to a price that is one minimum trading increment inferior to the ABBO, and (2) disseminate the re-priced DNR Order as part of the new PBBO.⁶⁵

J. Other Items

Under the proposed rule change, the system would give priority to market orders first in time priority, then resting limit orders, and the allocation provisions of Rule 1014(g)(vii) would apply.⁶⁶ Further, the Exchange proposes that when the option series opens, the system would disseminate the price and size of the PBBO.⁶⁷ In addition, the Exchange proposes to delete rule text in current Rule 1017(i), which currently provides that a limit order to buy at a higher price than the price at which the option is to be opened and a limit order to sell which is at a lower price than the price at which the option is to be opened shall be treated as market orders. The

⁶³ Id.

⁶⁴ This is substantially the same as the current rule text in existing Phlx Rule 1017(l)(vi)(C)(8).

⁶⁵ This is substantially the same as the current rule text in existing Phlx Rule 1017(l)(vi)(D).

⁶⁶ Phlx Rule 1017(k)(E).

⁶⁷ Phlx Rule 1017(k)(F).

Exchange is deleting this text because it treats these orders as limit orders, which the Exchange believes is consistent with participants' expectations.⁶⁸

The Exchange also proposes to delete current Rule 1017(l)(ix), which provides for a delay to calculate the opening. The Exchange's current technology does not require a delay in order to open, and the Exchange states that therefore, this requirement is obsolete.⁶⁹ Further, the Exchange proposes to delete current Rule 1017(l)(x), which addresses when the ABBO becomes crossed. The Exchange states that the impact of the ABBO is now discussed throughout the rule, and this provision is therefore unnecessary.⁷⁰

III. Discussion

After careful review, the Commission finds that the proposed rule change, as modified by Partial Amendment No. 2, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁷¹ In particular, for the reasons discussed below, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁷² which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

⁶⁸ See Notice, supra note 3, at 56740.

⁶⁹ Id.

⁷⁰ Id.

⁷¹ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁷² 15 U.S.C. 78f(b)(5).

A. Definitions and Organizational Changes

The Commission notes that, generally, the Exchange is proposing changes to the definitions described in Section II.A to better organize and clearly convey for readers existing concepts that are throughout the Exchange's Opening Process rules. The Commission notes that the Exchange is proposing to eliminate from the definition of "market for the underlying security" under Rule 1017(a)(v) the phrase the "first market to open." The Exchange represents that it does not currently use the first market to open to determine the market for the underlying security and will only use the primary listing market and primary volume market to determine the underlying market.⁷³ In addition, use of the term "Phlx Electronic Market Maker," rather than "Phlx XL Participant," should reduce investor confusion because "Phlx XL Participant" includes non-SQT Registered Options Traders or ROTs,⁷⁴ who cannot submit quotes electronically, and are not be subject to Rule 1017 because Rule 1017 applies only to electronic trading. The Commission notes that the Exchange is proposing to reorganize several provisions of Rule 1017, which should improve the clarity and readability of the Exchange's rules.

B. Interest Included in the Opening Process

The Commission notes that the Exchange is proposing that all-or-none interest that can be satisfied would be considered for execution and in determining the Opening Price throughout the Opening Process. The Exchange is also proposing to aggregate the size of all eligible interest for a particular participant category at a particular price level to determine the pro-rata allocation⁷⁵ rather than using only Opening Sweeps. The Commission believes that these

⁷³ See Notice, supra note 3, at 56734.

⁷⁴ A non-SQT ROT is an ROT who is neither an SQT nor an RSQT. See Rule 1014(b)(ii)(C).

⁷⁵ Phlx Rule 1014(g)(vii).

proposed changes could benefit investors by increasing interest included in the Opening Process and potentially result in a better Opening Price. The Commission notes that the allocation methodology used would be consistent with existing Phlx rules. The Commission also notes that the proposed rule change provides for time frames for orders and quotes to be entered on the Exchange pursuant to Phlx Rule 1017(d) and the conditions under which the Opening Process would occur. The Commission believes that these proposed rule changes could provide investors with more certainty around when interest can be submitted to the Exchange and the conditions required for the Opening Process to begin.

C. Opening Processes and Reopening After a Trading Halt

As discussed in Section II.C, proposed Phlx Rule 1017(d) sets forth the Opening Process for an option series, which the Exchange represents is the same as the requirements under current Rule 1017(k). The Exchange represents that throughout the Opening Process, there will be no different impact to any particular participants and that executions occur at the most reasonable price possible regardless of participant type.⁷⁶

The Commission believes that the Exchange's proposal to provide a delay between the opening of the underlying and the related option is not novel⁷⁷ and would provide the Exchange with flexibility to help ensure a stable Opening Process to determine the price of an option. The Commission notes that proposed Rule 1017(d)(iii) and (iv) sets forth time frames for a Specialist to enter a Valid Width Quote and the requirements for a Phlx Electronic Market Maker to enter continuous, two-sided quotes, which according to the Exchange, are unchanged from the current rule text.⁷⁸ The Commission believes that the Exchange's proposal to make explicit in Rule

⁷⁶ See Notice, supra note 3, at 56741.

⁷⁷ See Chicago Board Option Exchange Rule 6.2B(b).

⁷⁸ See Notice, supra note 3, at 56736.

1017(d)(iv) that the Opening Process would stop and an option series would not open if the ABBO becomes crossed or when the requisite number of Valid Width Quotes pursuant to Rule 1017(d)(i) are no longer present, at which time the process would be re-started, would benefit investors by clarifying the operation of the rule.

Lastly, new Rule 1017(e) states that the procedure described in Rule 1017 may be used to reopen an option after a trading halt. This concept is currently in Rule 1017(h) except that the Exchange is adding that if there is a trading halt or pause in the underlying security, the Opening Process would start again irrespective of the specific times listed in Rule 1017(d). The Commission notes that the times listed in Rule 1017(d) relate to the normal market opening at 9:30 a.m. and thus would not be appropriate for re-openings, which do not occur at the beginning of the trading day. The Commission believes that these proposals should promote an orderly opening following a trading halt.

D. Opening with a PBBO and Pre-Market BBO Calculation

As discussed in Section II.D, the Exchange is proposing that it would open with an opening quote by disseminating the PBBO only if there are no opening quotes or orders that lock or cross each other and no routable orders locking or crossing the ABBO. The Commission notes that this proposed change comports with the Exchange's existing rules,⁷⁹ and is designed to help ensure that the Exchange does not open with a price that would cross away markets. The Exchange is also proposing that in the event of a Zero Bid Market, no ABBO, and no Quality Opening Market, the Exchange would conduct the PDM and calculate an OQR. The Exchange believes that when these three conditions exist, it is difficult to arrive at a reasonable and expected price and that the proposed change is designed to avoid opening executions in very

⁷⁹ See current Phlx Rule 1017(l)(x).

wide or unusual markets.⁸⁰ The Commission notes that the Pre-Market BBO Calculation remains substantially unchanged from Phlx's previous rules. The Commission believes that the proposal could result in a more reasonable Opening Price, to the benefit of investors.

E. Potential Opening Price and Opening With a Trade

As discussed in Section II.F, the Exchange is proposing that in calculating the Potential Opening Price, the system would consider all Valid Width Quotes, Opening Sweeps, and orders, except all-or-none interest that cannot be satisfied, and identify the maximum quantity criterion. The Commission believes that specifying the interest considered in determining the Potential Opening Price would allow market participants to better understand the operation of the rule. The Exchange is proposing that when two or more Potential Opening Prices would both satisfy the maximum quantity criterion and leave no contracts unexecuted, the system would take the highest and lowest of those prices and take the mid-point. The Commission notes that this is based on current Phlx Rule 1017(l)(ii)(B). The Commission believes that the Exchange's proposal to use the lowest executable bid or the highest executable offer of the largest sized order in the event of a tie among Potential Opening Prices that would satisfy the maximum quantity criteria and leave contracts unexecuted could provide for more orderly opening. As further discussed in Section II.F, the Exchange has also proposed that the Potential Opening Price would be bounded by the away market price that could not be satisfied with the Exchange routable interest, which is designed to prevent opening with a trade that would trade through another market.

As discussed above in Section II.G, the proposal describes the conditions under which the Exchange would open with a trade using certain price boundaries for the Potential Opening

⁸⁰ See Notice, supra note 3, at 56741.

Price. The Commission notes that the conditions specified in Rule 1017(i) are designed to identify a reasonable Opening Price for an options series to open on the Exchange without trading through the prices of other markets.⁸¹

F. Calculation of Opening Quote Range

As described in Section II.H, the Exchange is proposing to add additional criteria to the OQR, which is applied as a boundary during the PDM. According to the Exchange, the OQR is designed to act as a protection for the Opening Price because it protects away market prices and also protects against extreme volatility, which impacts the Opening Price.⁸² The Commission believes that the proposed changes to the OQR could help the Exchange better maximize the amount of interest to be considered during the Opening Process and arrive at a reasonable Opening Price in light of both interest present in the system and away market interest, to the benefit of investors. The Exchange also proposes that the system would consider routable customer interest in price/time priority to satisfy the away market, which is consistent with the priority treatment of orders the Exchange applies at other times throughout the trading day.⁸³

G. Price Discovery Mechanism

The PDM seeks to identify an Opening Price if the Exchange has not already done so through the processes provided in 1017(f) and (i). The PDM is designed to attract liquidity to improve the price at which an options series will open and maximize the number of contract that can be executed at the opening.⁸⁴ The Commission notes that, while many of the processes of the PDM under proposed Rule 1017(k) are the same under existing Rule 1017 and that many of

⁸¹ See Notice, supra note 3, at 56741.

⁸² Id.

⁸³ See, e.g., Phlx Rule 1014(g)(vii).

⁸⁴ See Notice, supra note 3, at 56741.

the changes describing the PDM process would reorganize the current rule text to add clarity, the Exchange is also proposing changes to the manner in which the PDM operates, as identified above. As described above, the Exchange has proposed to clarify when it will route interest to away markets during the Opening Process and the use of Imbalance Messages. In addition, the Exchange states that the proposed changes to price contracts that it routes to away markets at the Opening Price or the order's limit price are designed to achieve the best possible price for participants.⁸⁵ The Commission notes that the proposed changes to the PDM are designed to improve the execution prices for market participants, ensure that the Exchange does not trade-through an away market price, and add clarity to its rules by deleting obsolete rules and providing more detail. The Commission believes that the proposed changes to the PDM could help the Exchange achieve the goals of the PDM and could provide better executions to participants.

H. Other Items

The Commission notes that the Exchange's proposal to handle limit orders in the same manner at the opening as throughout the rest of the trading day is consistent with the practices of other exchanges, which do not provide that limit orders would be treated differently at different times in the trading day.⁸⁶ Finally, the Commission believes that the proposal to remove the delay to calculate the opening in current Rule 1017(l)(ix) would be in the best interest of investors because, as the Exchange represents, such delay is no longer necessary, and therefore, obsolete.

⁸⁵ See Notice, supra note 3, at 56741.

⁸⁶ See, e.g., Chicago Board Option Exchange Rule 6.2B(c)(iv) and BOX Rule 7070(e)(q), each of which provide that during the opening, the system would give priority to market orders.

IV. Solicitation of Comments on Partial Amendment No. 2

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Partial Amendment No. 2 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2016-79 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2016-79. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the

Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2016-79 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of Proposed Rule Change, as Modified by Partial Amendment No. 2

The Commission finds good cause to approve the proposed rule change, as modified by Partial Amendment No. 2, prior to the 30th day after the date of publication of notice of Partial Amendment No. 2 in the Federal Register. Partial Amendment No. 2 revised the proposed rule change by: (1) specifying that references to “quotes” refer to two-sided quotes; (2) providing additional rationale for the OQR and for boundaries that protect the Opening Price from trading through the limit price(s) of interest within OQR which is unable to fully execute at the Opening Price; (3) stating that in the event the Exchange routes to away markets and uses the away market price as the Opening Price, the Exchange will enter on its order book any unfilled interest at a price equal to or inferior than the Opening Price and the Exchange would route orders that would execute through the Opening Price; (4) explaining that each Imbalance Message will be set for the same length of time; (5) including additional rationale for proposed changes to routing during the Opening Process; (6) providing examples for how certain parts of the Opening Process operate; and (7) revising the filing and Exhibit 5 to state that the Exchange may open with the PBBO only if there are no routable orders locking the ABBO.

Partial Amendment No. 2 supplements the proposed rule change by, among other things, clarifying the interest included in the Opening Process and providing additional explanation and detail about several aspects of the Exchange’s Opening Process. It also helps the Commission

evaluate whether the proposed rule change would be consistent with the protection of investors and the public interest.

Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,⁸⁷ to approve the proposed rule change, as modified by Partial Amendment No. 2, on an accelerated basis.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁸⁸ that the proposed rule change (SR-Phlx-2016-79), as amended by Partial Amendment No. 2, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁸⁹

Brent J. Fields
Secretary

⁸⁷ 15 U.S.C. 78s(b)(2).

⁸⁸ Id.

⁸⁹ 17 CFR 200.30-3(a)(12).

